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December 28, 2001

VIA FACSIMILE AND ELECTRONIC MAIL

Defense Acquisition Regulations Council

Attn: Ms. Susan Schneider

OUSD(AT&L)DP(DAR)

IMD 3C132

3062 Defense Pentagon

Washington, D.C. 20301-3062

Re: DFARS Case 99-D028

Defense Federal Acquisition Regulation Supplement

Anticompetitive Teaming

66 Fed. Reg. 55157 (November 1, 2001)

Dear Ms. Schneider:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section's governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the American Bar Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.

Background

The Federal Acquisition Regulation ('FAR') requires agency personnel to report suspected antitrust violations to enforcement authorities. ~~See FAR Subpart 3.3.~~ Specifically, FAR 3.303 provides for referral to the Attorney General of various "practices or events that may evidence violations of the antitrust laws." This FAR provision identifies for referral nine practices that are typically ~~considered~~ *per se* violations of the antitrust laws, such as bid rigging, division of markets, and collusive estimating systems.

The proposed revision to the DFARS would add "exclusive teaming arrangements" to the list of potential antitrust violations. ~~An earlier~~ DFARS proposal on the same subject (64 Fed. Reg. 63002, November 18, 1999) would have required reporting of such arrangements under two conditions: (i) one or a combination of the companies participating on the team is the sole provider of a product or service that is essential for contract performance; and (ii) efforts to ~~eliminate~~ the arrangements are not successful.

The current proposed rule adds a further condition to reporting ("The teaming arrangement impairs competition . . ."), and makes it clear that all three ~~conditions~~ must be met for the arrangement to be reportable. Finally, the proposed rule cautions that the policy "should not be misconstrued to imply that all exclusive teaming arrangements evidence violations of the antitrust laws,"

Comments

The Section supports the goal of curbing practices that may unreasonably impair competition. The Section is concerned, however, that there is no demonstrated need for the proposed DFARS provision. In addition, the Section believes that the provision is ripe for misapplication, which would result in unwarranted referrals to the Attorney General, as well as unnecessary delays and costs in the acquisition process. Ultimately, such risk and disruption may deter contractors from entering into teaming arrangements that would ~~otherwise~~ benefit the Department of Defense ("DoD"). These concerns and risks are addressed in detail below.

1. **No Demonstrated Need for the Proposed Rule**

Contractor teaming arrangements have long been an accepted practice in federal contracting, and the need for such arrangements has remained strong over the past ten years as companies have increasingly focused on their own core ~~competencies~~. Non-exclusive teaming arrangements are generally used when one team member or both are unwilling to make substantial investments of time or resources in the joint effort. By contrast, exclusive teaming arrangements are common where, in order to

justify each team member's investment in the joint effort, it is necessary that **all** members be assured that the effort will benefit only that team. Exclusive teaming arrangements are particularly common in major systems acquisitions.

The FAR currently recognizes -- and would continue to do so even if the **DFARS** revision were adopted -- that teaming agreements:

may be desirable from both the Government and industry standpoint in order to enable the companies involved to --

- (1) Complement each other's unique capabilities; and
- (2) Offer the Government the best combination of performance, cost and delivery for the system or product being acquired.

FAR 9.602(a).

In addition, ~~the~~ agencies responsible for enforcing the antitrust laws -- the Department of Justice ("**DoJ**") and the Federal Trade Commission ("**FTC**") -- also have recognized the benefits of teaming agreements and strategic alliances. In "Antitrust Guidelines for Collaborations Among Competitors," published in April 2000, the agencies stated:

Efficiency gains from competitor collaborations often stem **from** combinations of different capabilities or resources. For example, one participant may have special technical expertise that usefully complements another participant's manufacturing process, allowing the latter participant to lower its production costs or to improve the **quality** of its product. **In** other instances, collaboration may facilitate the attainment of scale or scope of economies beyond the reach of any single participant.

...

DOJ/FTC Guidelines, § 2.1..

Indeed, in certain circumstances, teaming can be the source of competition in a procurement. **In** large systems procurements and in large bundled-services acquisitions, for example, the agency's requirements **often** dictate the alliance of companies with complementary capabilities to satisfy all **contract** requirements. Thus, the ability to team exclusively in an **environment** that facilitates the free exchange of

proprietary technical and cost data allows companies to come together and “create” a competitor, thereby enhancing competition,

Given the widely acknowledged advantages of teaming, and the regular use of exclusive arrangements in federal contracting, the rationale for DoD’s departure from existing practice is not clear. It is not in the interest of the DoD, or the defense industry on which it depends, to discourage the formation of teaming agreements that allow firms to combine their complementary technological know-how and manufacturing capabilities to best meet the Government’s needs,

The initial impetus for regulations addressing anti-competitive teaming arrangements was the Memorandum of Under Secretary of Defense Jacques Gansler, dated January 5, 1999. The memorandum arose in part out of concern about a teaming arrangement for the DD-2 1 Destroyer acquisition that DoD perceived as restricting competition. Notably, that concern was subsequently resolved under the existing regulations.

The commentary accompanying the proposed rule cites no example of any other major acquisition during the past three years in which concerns about restricted competition have arisen from a teaming agreement, nor is the Section aware of any analysis that indicates a systemic problem in the area. Thus, it appears that, to the extent there may have been problems within DoD regarding exclusive teaming arrangements in the past, Dr. Gansler’s Memorandum may have accomplished its purpose without the need for additional regulation.

Accordingly, because no clear need for the proposed rule has been articulated, and because its potential for misapplication and disruption of the acquisition process are great (*see* part 2 *infra*), the Section recommends that the proposed rule be withdrawn .

2. Potential Misapplication and Disruption of the Acquisition Process

In evaluating the potential impact of the proposed rule, it is important to start with the understanding that (i) there is nothing presumptively wrong with exclusive arrangements under antitrust law and (ii) the determination of whether an exclusive arrangement is “anti-competitive” requires a fairly complex, nuanced analysis of antitrust law.

The potential antitrust violations that are currently identified in FAR 3.303(c), including bid rigging and division of markets, usually are the product of conspiracies of the type considered by the antitrust laws to be *per se* violations-that is, they are unlawful regardless of any economic justifications the conspirators may offer. By contrast, exclusive teaming arrangements are a form of exclusive dealing that the

courts judge by a much more lenient “rule of reason,” which balances anti-competitive **harm** against pro-competitive benefits.

In determining whether a collaboration is “anti-competitive” and thus subject to enforcement action, the enforcement agencies engage in 3 multi-factor analysis that includes: (i) defining the relevant market affected by the collaboration; and (ii) carefully balancing the pro-competitive benefits of the collaboration against the anti-competitive effects. In defining the relevant market, the enforcement agencies consider not only firms that are presently providing the product or service in question, but also firms that could potentially enter the market in response to a price increase or restriction of output.

Thus, the fact that one of the firms in an exclusive teaming arrangement is *presently* “~~the~~ sole provider of a product or service that is essential for contract performance” -- the threshold criterion in the proposed rule -- does not mean that the arrangement will be found to restrain competition if, in fact, there are other potential suppliers or service providers that have the facilities and technical capability to compete,

Exclusive teaming arrangements also may promote pro-competitive efficiencies that outweigh any anti-competitive **harm** that could result. The most obvious benefit of exclusive teaming is that the team members will strive to **promote** their combined effort to the utmost, and thus provide the best option their combined competencies represent, both because they are assured that other teams will not **benefit** ~~from~~ their joint efforts and because their hope of **success** lies solely in the team’s success. Thus, exclusivity may be important to prevent one ~~teammate~~ from gaining access to the other teammate’s technical **data** or approach, **and** then utilizing that knowledge in support of 3 competing contractor’s **proposal** in response to the solicitation. Such “free riding” can actually have anti-competitive effects by providing a cost-free technical “windfall” to a competing contractor. Exclusivity in a teaming **arrangement** can prevent such “**free** riding” and thereby promote, rather than impair, competition.

Unfortunately, the broad terms of the proposed **rule** provide no guidance for determining when an offeror is a “sole provider” of an essential item or when. an exclusive arrangement “impairs competition,” and contracting officials **cannot** be expected to perform the subtle legal **analysis** that enforcement agencies perform. For example, the rule provides little basis to distinguish between a contractor team with a legitimate – and perhaps dispositive – competitive advantage **and** one who, as the “sole provider” of ~~an~~ “essential item,” may “impair competition.”

The likely result will be unwarranted suspicion of exclusive teaming arrangements and frequent reporting to the **DoJ** of arrangements that actually meet antitrust laws and promote competition. Such unnecessary **referrals** to **DoJ** could significantly delay acquisitions while the **allegedly** offending arrangement is investigated, as well as impose substantial costs on the teaming companies to defend their arrangement.

Moreover, without clear regulatory **criteria**, companies will be unable to determine whether or not their contemplated teaming arrangements will be deemed potentially "anti-competitive" by **contracting officials** and, therefore, whether they risk referral to the **DoJ** by entering into such arrangements. This lack of clarity can only lead to a chilling of many arrangements that would actually enhance competition in defense acquisitions. If our prognosis is correct that contracting officers will err on the side of referring agreements that arguably meet **the** broad criteria in the proposed rule, the use of exclusive teaming arrangements could decline precipitously, to everyone's detriment.

Conclusion

In sum, the Section believes that **there is** no demonstrated need for the proposed DFAR provision and that its implementation would result in unwarranted referrals to the **DoJ**. Such referrals would disrupt the contracting process and ultimately may deter **contractors** from teaming arrangements that produce efficiencies, increase quality and innovation, and lower acquisition costs. Therefore, the Section recommends that the proposed DFAR **provision** be withdrawn **and** that the **DoD** continue to operate under existing law.

In the alternative, if the **DoD** goes forward with the rule, the Section suggests that more precise criteria be developed that contracting officials and the contracting community can easily apply and that will not unduly inhibit legitimate teaming arrangements.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,



Norman R. Thorpe
Chair, Section of Public Contract Law

Defense Acquisition Regulations Council
December 28, 2001
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